STRAITS SETTLEMENTS REPORTS.

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[ORIGINAL CIVIL JURISDICTION]
MANNING, J.
June 13, 1939.

THE MALACCA MERCANTILE CO-OPERATIVE THRIFT & LOAN SOCIETY LTD.

(Petitioners)

v.

THE ATTORNEY GENERAL.

(MALACCA CROWN SUIT No. 1 of 1939)

Co-operative Societies Ordinance Section 17 (1)—annual audit—liability of Registrar for negligence of auditors—liability of Government.

The Petitioners were a Society registered under the Co-operative Societies Ordinance. Section 17 (1) of that Ordinance provides that the Registrar of Co-operative Societies shall cause to be audited the accounts of every registered society once at least in every year.

Held, that the duty of auditing such accounts owed by the Registrar is imposed on him so that he may be in a better position to control and supervise the Co-operative Society. He does not owe such duty to the individual societies; it is a duty owed to the Government alone. The manner in which the audit is made does not concern the Society. Any by-laws made by the Society cannot impose on the Registrar a wider duty than that imposed by the Ordinance. If the auditors employed by the Registrar has in fact been negligent that does not render the Registrar liable to the Society.

Semble, if the Registrar himself has been negligent the Government is responsible for his negligence.

Semble also, liability may also be negatived or reduced by contributory negligence on the part of the Society or its officials.

M. B. Brash for the Petitioners.
P. Storr for the Attorney General.

Cur. Adv. Vult.

Manning, J. This is a petition of right under the Crown Suits Ordinance. The petitioner is the Malacca Mercantile Co-operative Thrift and Loan Society Ltd. (hereinafter referred to as the Society), a Society registered under the Co-operative Societies Ordinance (hereinafter referred to as the Ordinance). In the month of December, 1937, it was discovered that one Ferrao, the Honorary Secretary and Treasurer of the Society, had been for some time misappropriating the funds of the Society. Section 17 (1) of the Ordinance reads as follows:—

> "The Registrar shall audit or cause to be audited by some person authorized by him by general or special order in writing in this behalf the accounts of every registered society once at least in every year".

"Registrar" here means the person appointed by the Governor to be the Registrar of Co-operative Societies under the Ordinance. By-law 69 of the Society's by-laws reads as follows:—

> "A balance sheet must be made out every half year in January and July and presented to members at the January and July General Meetings, a copy being sent to the Registrar of Co-operative Societies at the same time. No dividend shall be distributed until after the balance sheet has been audited and passed by the Auditor appointed by the Registrar."

The Society says that both by section 17 (1) of the Ordinance and by by-law 69 the Registrar owed a duty to the Society to audit its accounts twice a year, or alternatively at least once a year. It says that such duty was not complied with by the Registrar or by the persons authorised by him, that no proper or sufficient audit was made between early in 1935 and December 8th 1937, and that whatever audit was made was not carried out with the requisite skill and care. It says that the Registrar failed to exercise due care in the selection of the persons whom he authorised to carry out the audit. It says that owing to this negligence of the Registrar and the persons authorised by him Ferrao was enabled to misappropriate a sum of nearly $5,000. It says that the Registrar was at all material times an executive officer of the Government, and that the Government is therefore responsible and liable to have judgment given against it for all damage caused to the Society by the said negligence.

Mr. Brash who appeared for the Society relied firstly on the plain words of the sub-section 17 (1). He pointed out that the word "shall" is used, and that a statutory duty is thereby created, and a duty owed by the Registrar to the Society. He construed the sub-section into an undertaking by the Government to each Society that the Registrar will have its accounts audited at least once a year. He further relied on the fact that certain societies may be allowed to select their own auditors as distinct from the Audit Department controlled by the Registrar. I think this latter point does not help his case. If a society is allowed to select its own auditors, these auditors must be regarded as persons authorised by the Registrar to make the audit.

Mr. Storr puts the case for the Government as follows. He says that the Registrar is responsible to the Government only and not to the Society, that the audit contemplated by the sub-section is one which the

Government considers should be carried out for the better control of the Co-operative Societies, that no obligation is created by the section to make any report to the Society, and that the consequence of holding that a duty to the Society is created would be to undermine the whole purpose of the Ordinance and to free the management committee and the internal auditors of each society from any responsibility for the financial supervision. He called as a witness Mr. Cox, the auditor and accountant of the Co-operative Societies, who supervises the audits under section 17 (1) by the authority of the Registrar. Mr. Cox says he is the only qualified accountant in the department and that he has under him a number of travelling audit clerks who are sent out to audit in the various district. He says "I can't agree that the audit is done for the Society concerned, the audit staff that works for me has been built up on the understanding that the audit is for the Registrar and Government has no liability to Societies. If the audit was for Societies I calculate I should want 6 qualified accountants to supervise the work of the existing audit staff. That would entail expense".

The question may be looked at from two points of view. Was this sub-section enacted for the protection of the members of the various societies, or was it enacted to ensure that the Registrar exercised supervision over the financial working of the Societies? Mr. Brash has cited the case of *Monk v. Warbey and others*, 1935, 1 K.B., 75. That case decided that if a penalty is imposed for breach of a statutory duty, this does not necessarily preclude a person injured by the breach from successfully suing in a civil action for damages. The object of the particular Statute is the criterion by which such a question must be decided. In that case the object of the relevant legislation was to ensure that persons injured in motor car accidents should be compensated for the injuries sustained by making it obligatory on motor car owners to insure against accidents to third parties. The case of *Groves v. Lord Wimborne*, 1898, 2 Q.B. 402, was cited in the argument and in the judgments in favour of the plaintiff Monk. This case depended on the provisions of an Act which in the words of A. L. Smith, L.J., was "a public act passed in favour of the workers in factories and workshops to compel their employers to do certain things for their protection and benefit". On the other side the case of *Philips v. Britannia Hygienic Laundry Co.*, 1923, 2 K.B., 832, was cited, in which it was held that it was not intended by the relevant legislation that every one who might be injured by its breach should have an action for damages. I refer to these authorities for the purpose of showing that in a question such as this decided cases can be of little help except to emphasise that each case must be examined in the light of the object and purview of the legislation which creates the duty.

The Ordinance is divided into parts, each part being headed by a title. By section 4 (b) of the Interpretation Ordinance Courts are required to take notice of the fact and particulars of such division. Sections 15, 16 and 17 of the Ordinance are included in one division. The title of this division is "Duties of Registered Societies". Sections 15 and 16 relate to the duty of each society to have a registered address and to keep open to inspection there copies of the Ordinance, rules and by-laws. Section 17 (1) has been already set out. Section 17 (2) states certain matters which must be included in the audit. Section 17 (3) is as follows:—

> "The Registrar, the District Officer, or any person authorized by general or special order in writing in this behalf by the Registrar shall at all times have access to all the books, accounts, papers and securities of any society, and every officer of the society shall furnish such information in regard to the transactions and working of the society as the person making such inspection may require".

The duty of the officers of the registered society to give full information is stressed. I read the whole of section 17 as imposing a duty on societies to give full information to the Registrar or other persons authorised to enable the audit to be carried out. The Registrar has a duty imposed on him to audit at least once in each year, but the societies are not concerned as to whether he does so or not. If he does so, the officers of the societies must give all required information. I am in agreement with Mr. Storr that the duty owed by the Registrar is a duty owed to the Government and to the Government alone. The economical grounds put forward by Mr. Cox are irrelevant. Other sections of the Ordinance are of importance. Under section 38 the Registrar may of his own motion order an inquiry into the constitution, working and financial condition of a registered society. Under section 43 he may, after such an inquiry, come to the conclusion that the society ought to be dissolved and he may cancel its registration. I think that the audit at least once a year is for the purpose of keeping

the Registrar *au fait* with the financial condition and the working of each society, so that he may be in a position to decide at any time whether an inquiry should be held under section 38. In this connection the words of section 17 (2) are not unimportant, it is specifically stated that the audit "shall include an examination of overdue debts, if any, and a valuation of the assets and liabilities of the society". I agree with Mr. Storr that this audit is imposed on the Registrar as a duty so that he may be in a better position to control and supervise the societies. He does not owe this duty to the individual societies. The society in the present case (and I have no doubt other societies do the same) has provided in its by-laws for a proper check on its finances being kept by the managing committee and for a monthly audit by members who must not belong to this committee.

A further question arises in this connection, and it is this. If the Registrar does carry out the audit, does he owe a duty to the societies to authorise persons of reasonable skill to carry it out, and a further duty that it shall be carried out with reasonable skill and care? I think the answer to this follows from what I have just held to be the interpretation of the section. The audit is carried out by the Registrar for his own information, so that he may see how the societies are working. If the audit is carried out inefficiently, it means that his department is not being successfully managed. That is a matter for him and for the Government which employs him. The manner in which the audit is made does not concern the societies.

It has been suggested that the fact that the Registrar sent reports to the society on its working indicates that he owed a duty to it to audit and to audit efficiently. Section 17 of the Ordinance does not provide for any report by the Registrar on the result of the audit. But he naturally sends reports to call attention to matters which may strike him as important. This he does, not because it is a duty which he owes to the society, but because he owes a duty to the Government to supervise the working of the society and to point out details which will make for improvement.

With regard to by-law 69 Mr. Brash says the Registrar has accepted the by-laws and therefore this particular one is binding on him. He points out that the Society cannot function unless the half-yearly balance sheet has been audited and passed by the Auditor appointed by the Registrar and that this therefore implies a duty owed by the Registrar to the Society to appoint an Auditor to audit and pass the half-yearly balance sheets. Mr. Storr says the by-laws are binding only on the members of the society and cannot affect the Registrar in any way.

I do not think it is accurate to say that the Registrar has accepted the by-laws in the sense that he has taken on himself any contractual obligation. The by-laws are registered by the Registrar if he is satisfied that they are not contrary to the Ordinance or to the rules made under the Ordinance. I have already held that section 17 (1) of the Ordinance does not create a duty owed by the Registrar to the Society. The by-laws cannot impose on the Registrar a wider duty than that imposed by the Ordinance. The true meaning of by-law 69 is that the Society voluntarily imposed on itself a restriction prohibiting the distribution of dividends until something should have been done. The emphasis in the last sentence of the by-law is on the restriction, it is not susceptible of the interpretation that the Society may call on the Registrar to appoint an auditor and that the Registrar is bound to comply. In the ordinary course of events it may be anticipated that the balance sheets will be audited and passed at least once a year, and if the Society likes to hold up the distribution of dividends pending the audit, it can do so. It is freely admitted that the Society came to ignore this self-imposed restriction, and distributed a dividend without waiting for the balance sheet to be audited.

I hold, therefore, that neither under section 17 (1) of the Ordinance nor under by-law 69 did the the Registrar owe any duty to the Society.

[The Judge then proceeded to deal with the facts on the question of negligence and continued.—]

This disposes of the petition, but in case the matter may be taken further, I shall deal with particulars of alleged negligence. The first of these relates to the bank pass-book of the Society. It was not really the pass-book of the Society, it had been originally issued by the bank to another person, whose name was on the outside cover. Over this name a piece of paper had been pasted on which was typed the name of the Society. The first page of the pass-book which usually contains the title of the bank and the name of the customer had been torn out. Mr. Cox admits that this last matter would cause him to be suspicious. Mr. de Souza, who was the audit clerk engaged on this particular audit by authority of the Registrar, says he never looked inside the pass-book to see the name of the bank and the accounting party and that he

never did this during any of his audits. The pass-book was one of the means used by Ferrao to deceive any person inspecting his accounts. The entries in it began on November 30th 1935. The next audit by a person authorised by the Registrar was on May 20th 1936. After that three audits were made by Mr. de Souza before it was discovered that Ferrao was defrauding the Society. I find that whoever made the audit on May 20th 1936 and Mr. de Souza showed a lack of skill and care in not detecting that this was a fictitious pass-book.

The next particular relates to a certificate of the bank balance of the Society. The certificate showed a balance in "our" favour, and by a very clever forgery the "our" was altered to "your". In my opinion no blame can be attached to any auditor for failing to detect this. A proper certificate was later obtained from the bank and point is made of the fact that the forged and the correct certificates were seen filed together on the auditor's record and it is said this should have given rise to suspicion. Mr. Cox explains how they came to be filed together—the correct one had been obtained from the bank and filed. Some time after December 30th 1937 he found the forged certificate among the papers of the 1936 audit and filed it next to the correct one. Mr. Cooper, the President of the Society, said that he saw the two certificates on the file together on the 9th December, numbered as they are now. The correct one is No. 32, and the forged one is No. 33. As Mr. Cox did not return from leave till 30th December, 1937, and as he numbered the forged one, I think Mr. Cooper must be mistaken in his recollection as to the date when he saw the two certificates on the file. There is no evidence that any one authorised by the Registrar saw the two certificates in conjunction until after the defalcation had been discovered and an inquiry was being held. Mr. Brash has also made a point of the fact that the balance as certified by the bank as at 31st December 1936 was $1,522.32, while on the balance sheet of the Society sent to the Registrar the bank balance was shown as $1,977.84. He says that even if the forgery was undetected it shou'd have been seen that these balances did not agree and there should then have been an immediate inquiry. Mr. Cox says it is not the practice to check the bank certificate with the balance sheet sent in by the Society. His is the only evidence I have as to what ought to be done, and I am not prepared to say that there was any lack of care in this connection.

The next particular is with reference to the Post Office Savings Bank of the Society. One of the methods employed by Ferrao was to show in his accounts a sum deposited in the Post Office and when the book was called for to say he had mislaid it. Mr. de Souza said that for months he was attempting to get Ferrao to produce this book, but was always put off by a statement that the book had been mislaid and would be produced later. I think this shows how incompetent Mr. de Souza was to be entrusted with duties of this kind. A report on the matter to the Registrar or to the Chairman of the Society must have led to enquiries at the Post Office, and the true state of affairs would have been revealed. The book was produced to the person authorised by the Registrar to audit on May 20th 1936. It was then in order, the entries corresponding to those in the ledger. It was on May 31st 1936 that Ferrao began to make fictitious entries in the ledger. The three audits after that date were made by Mr. de Souza, the first being on November 12th 1936.

The next particular relates to the failure of the auditor to detect fictitious bank paying-in slips. Mr. Cox said that in auditing very little attention is paid to such slips and that it is not usually necessary to call for them. I am unable to find any lack of care as regards this particular.

The next particular deals with the failure of the Registrar to advise the Society that its books and affairs were not in order and that there was cause for suspicion. This can scarcely be regarded as a separate particular. There had been a lack of skill and care on the part of the persons authorised in failing to detect that the bank passbook was a fictitious one and in failing to insist on the production of the Post Office Savings Bank Book. Owing to this lack of skill and care these persons had no knowledge that the affairs of the Society were not in order. Attention, however, has been particularly called to a report by Mr. Cox made on May 10th 1937 stating that the Society's books and accounts were well maintained. In his evidence Mr. Cox says he did not mean that the books were accurately maintained, he meant that at a cursory glance they were written up to date, decently written. He says "well maintained" means well written-up, not necessarily correct. He admits he did not see the Post Office Savings Book or the Bank pass-book. He admits that the report might have been a trifle misleading in the light of subsequent events. I am of opinion that the report showed a lack of care on his part, and must have led the Society to believe that all its books were not only written up to date, but that the entries in them were correct.

Lastly in paragraph 19 of the petition it is said that the Registrar failed to exercise due care in the selection of the persons authorised to carry out the audits. I have already indicated that Mr. de Souza was incompetent and should not have been entrusted with duties of this kind. It is quite probable that whoever made the audit on May 20th 1936 was also incompetent, as he failed to detect that the pass-book was fictitious.

In case I am wrong in holding that the Registrar owed no duty to the Society I propose to consider the defence of contributory negligence pleaded by the Attorney-General. It is admitted by the Chairman of the Society that the auditors appointed by the Society from among its own members were negligent in checking and perusing the accounts. He implies that if they had not been negligent they could quite easily have discovered the methods used by Ferrao to defraud the Society. He admits that the management committee has equally been guilty of negligence. It follows from this that most of the loss caused to the Society by the fraud of Ferrao could have been avoided if the auditors and management committee of the Society had carried out the duties imposed on them by the by-laws.

One of the duties of the management committee was "to receive and check accounts of officers appointed to receive and disburse money of the Society and to examine the vouchers therefor". (By-law 60 (ix)). It is not said how often this is to be done but it is clearly intended that it should be done regularly. I gather from the Chairman's evidence that it was not done at all. The Society's auditors are not members of the committee of management, and it is their duty "to investigate the accounts of the Society, examine the books monthly and sign them, if correct, and if they are found incorrect to report to the President and the Chairman". (By-law 81). Some of the books appear to have been signed, but it is admitted that there was no adequate investigation and no adequate examination.

The frauds committed by Ferrao began about January 1935 and ended in December 1937. During all that period there should have been a regular check on him by the management committee—such a check would undoubtedly have revealed the fictitious nature of the bank pass-book and would have prevented any pretence of a balance in the Post Office Savings Bank greater than actually existed. A similar result must have followed the proper discharge of their duties by the auditors appointed by the Society. In fact it may be said that the exercise of the required vigilance by the management committee and the auditors of the Society might have altogether prevented Ferrao from attempting his fraud and that it would at any rate have led to the detection of any attempted fraud at an early date.

On the other hand the Registrar has to attend to the auditing of the accounts of about 600 societies. The admitted facts show that during the relevant period the time which the audit clerk was able to devote to the affairs of this Society was about twenty days. If there was any negligence on the part of the Registrar, it did not commence till May 20th 1936, the date on which his auditor had the first opportunity of detecting that the bank pass-book was not genuine. Actual misappropriations had been going on since August 1935. Ordinary attention to their duties by the management committee and the auditors of the Society would have brought to light the misappropriations long before this date.

These considerations lead me to hold that the real and effective cause of the loss to the Society was the negligence of the management committee and of the auditors appointed by the Society under by-law 81. These two bodies could by the exercise of ordinary care have avoided the loss.

Mr. Brash, however, for the Society, has put forward the argument that the negligence of the management committee and of the auditors appointed by the Society is not the negligence of the Society. He says there were four joint tort-feasors, viz: Ferrao, the management committee, the auditors appointed from among the members, and the Registrar. The Society has a right to sue any or all, it has chosen to sue one only, the Registrar, i.e. the Government. No authorities have been cited, nor have I been able to find any, to help me to decide this matter. The management committee is appointed at the Annual General Meeting of the Society by the members. The auditors are also appointed by the members at an Ordinary General Meeting. In these circumstances I am of opinion that the negligence of either of these bodies is the negligence of the Society and that the Attorney-General has made out his plea of contributory negligence.

The next issue to be determined is the liability of the Government for the negligence of the Registrar, in case he is held to be negligent. Mr. Brash says the Registrar is an executive officer of the Government and the Government is liable for his acts and omissions. He

bases his argument on section 20 of the Crown Suits Ordinance and cites two authorities viz: *Attorney-General Straits Settlements v. Pang Ah Yew,* 1925 A.C. 556 and In *re Vairavan Chettiar v. Attorney-General Straits Settlements,* S.S.L.R. 1933 page 40. Mr. Storr did not put forward any argument against this contention of Mr. Brash. I think the authorities cited support the argument of Mr. Brash, and I hold accordingly.

If the Registrar has been negligent, I am unable, on the material before me, to assess the damage caused by such negligence, Ferrao began his misappropriations in August 1935—the negligence of the Registrar, if negligence there was, did not commence until May 20th 1936. In Mr. Cox's report (Exhibit 3) the misappropriations for each of the years 1935, 1936 and 1937 are set out. The amount for 1937 is $1,323.09, including interest on the bank over-draft. The Registrar would be responsible for this. The amount for 1935 was $1,204.81. The Registrar would not be responsible for any of this. The amount for 1936 was $2,268.49. I am unable to calculate how much of this was misappropriated after May 20th 1936. When such amount has been calculated and added to the misappropriations for 1937, there would have to be deducted a proportional amount of the sum recovered from Ferrao, viz: $2,744.40.

To sum up,

(a) I decide that the Registrar owed no duty to the Society to audit its accounts either yearly or half-yearly.

(b) I find that there was a lack of care and skill in the persons authorised by the Registrar to carry out the audits between May 20th 1936 and December 8th 1937.

(c) I find that there was contributory negligence on the part of the Society.

(d) I hold that, if the Registrar was negligent, the Government is responsible for that negligence.

On these decisions of law and findings of fact the petition will be dismissed. The parties have agreed that there shall be no order as to costs.

Petition dismissed.

END OF STRAITS SETTLEMENTS OFFICIAL REPORTS.